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MAR 10 1993

March 9, 1993

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Ms. Donna R. Searcy  
Secretary  
Federal Communications Commission  
1919 M Street, N.W., Room 222  
Washington, D.C. 20554

RE: In the Matter of Simplification of the Depreciation Prescription Process  
CC Docket No. 92-296

Dear Ms. Searcy,

Attached are the original and five copies of the Comments of United Telephone - Southeast, Inc. in the proceeding referenced above.

Sincerely,

Jay C. Keithley  
Vice President  
Law and External Affairs

Attachments

JCK/mlm

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

March 10, 1993

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
Washington, D.C. 20554

In the Matter of )  
Simplification of the ) CC Docket No. 92-296  
Depreciation Prescription )  
Process )

**COMMENTS OF  
UNITED TELEPHONE - SOUTHEAST, INC.**

**I. Introduction and Summary**

United Telephone - Southeast, Inc.<sup>1</sup> ("UTS") hereby submits its comments to the Notice of Proposed Rulemaking<sup>2</sup> issued by the Federal Communications Commission ("Commission") in this matter. The Commission released this NPRM as part of its drive to simplify and reduce the costs associated with regulation. UTS supports this process.

The Commission presents four depreciation prescription simplification alternatives for comment. UTS wholeheartedly supports the Price Cap Carrier Option, and views the Basic Factors Range Option and the Depreciation Rate Range Option as viable

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1. Formerly known as United Inter-Mountain Telephone Company. The Commission currently prescribes depreciation rates for United Telephone - Southeast Inc. and the Company is a price caps company.

2. Simplification of the Depreciation Prescription Process, Notice of Proposed Rulemaking, CC Docket No. 92-296, FCC 92-537 (released December 29, 1992) ("NPRM").

second-best alternatives that, with necessary modifications, would provide limited, but much needed, simplification to the depreciation prescription process. UTS does not support the Depreciation Schedule option.

## **II. Change in Depreciation Prescription Practices Is Needed**

The Commission noted in the NPRM that the current depreciation prescription practices are about 50 years old and that they reflect policies formulated during a time when there was little competition and little technological change.<sup>3</sup> UTS agrees with the Commission that since that time "the telecommunications industry has experienced considerable change," including "emerging competition in the local exchange market, and more rapidly changing technology."<sup>4</sup>

The National Telecommunications and Information Administration ("NTIA") also notes that traditional regulatory depreciation must be changed. NTIA states that:

Adherence to historical depreciation practices in the face of rapid technological change has meant that the investment assets on regulated firms' books of account are consistently and, in many cases, substantially overvalued.<sup>5</sup>

The interstate depreciation process needs to be examined in light of these changes and problems. Because

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3. Id. at ¶7.

4. Id. at ¶8.

5. NTIA, The NTIA Infrastructure Report: Telecommunications in the Age of Information ("Infrastructure Report"), October 1991 at 255.

competition is present and technology is changing rapidly, the depreciation prescription process must become more future-oriented to recognize these pressures. Carriers must respond quickly to customer demand for new services and technology. Unfortunately, at the current time, technological change is outpacing the existing depreciation prescription process.

Rapid advances in technology have shortened the time historically necessary for generational changes in telecommunications equipment and software. Current depreciation practices are increasingly inaccurate and slow to recognize technological and competition driven changes of service lives. This places carriers at increasing risk because the gap between technological change and established depreciation policy and practices is expanding.

LECs must respond quickly to the technological and competitive market pressures they are facing. If LECs do not respond, they risk losing their current customers to the "emerging competition." New entrants that compete with LECs can implement the newest technology unhampered by Commission control of their depreciation practices. In comparison, LECs must carry their embedded depreciation burden and are allowed to manage that burden only within the guidelines of existing depreciation practices. In order to fairly compete

with new entrants, Price Cap carriers should be allowed to utilize modern depreciation practices that provide the flexibility and speed needed to meet the demands of rapidly changing technology and competition.

In recognition of these same pressures, the Commission adopted price caps regulation to create "the incentives that occur in a competitive market."<sup>6</sup> The incentives should be carried over, consistent with current statutory mandate, to depreciation policies.

### **III. Adoption of the Price Cap Carrier Option Is Appropriate**

The NTIA, in its Infrastructure Report, observed that "regulatory depreciation practices should not affect LEC investment decisions" where price caps regulation has been adopted.<sup>7</sup> However, NTIA notes that the price caps plan adopted by the FCC fails to unlink regulation and depreciation practices. NTIA believes that the FCC's continued control over depreciation for price cap carriers, so that continued earnings monitoring may occur, dilutes the efficiency of the price caps plan.<sup>8</sup>

While the Price Cap Carrier Option<sup>9</sup> proposed by the Commission does not satisfy NTIA's concerns, of the four plans proposed, it best matches depreciation prescription practices with

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6. Id.

7. NTIA Infrastructure Report at 258.

8. Id. at 259.

9. Id. at ¶40-42.

"the incentives that occur in a competitive market" as created by price caps regulation. UTS fully supports this proposal. The price caps regulation plan already contains a significant protection against potential abuse of the depreciation process: depreciation changes are endogeneous to price cap formula calculations. Thus, if a LEC speeds up depreciation it does not have the opportunity to recognize this change in the price caps formula. It must absorb depreciation changes in its earnings. As a result, LECs under price caps using the price cap carrier depreciation option have little incentive to increase or decrease depreciation rates for other than technology or investment-based reasons because these changes cannot affect service prices. This is the same incentive available in a truly competitive market where regulations do not control pricing or depreciation practices.

UTS envisions a process where a price cap carrier would file statements A and B with a justification letter or statement. These filings would contain information on the key dimensions of depreciation and include investment levels, remaining life, future net salvage, reserve ratios, rates and changes in accruals. Filings would be made on an annual basis. After receipt of this information, the Commission would issue a public notice. All comments received would be considered by the Commission and an order authorizing implementation of the proposed depreciation rates or requiring other appropriate action would be issued.



UTS supports this option for price cap carriers because it places the primary responsibility for developing depreciation proposals where it belongs--on the affected carrier. The carrier must focus on the future and plan how its investment will be recovered. Further, this option is the least complex of the alternatives and provides the most simplification.

The Commission seeks comment on whether the price cap carrier option and its interrelation to carrier sharing of earnings poses any risk.<sup>10</sup> A price cap LEC could use depreciation practices to micromanage earnings and "game" the sharing process. This is the only weakness in the price cap carrier option that UTS and others have identified.<sup>11</sup>

To prevent this unintended consequence, UTS recommends that the Commission track depreciation changes under this option over a multi-year time span. Part of the filing package by carriers should be such a historical showing over five years. If, after addressing the current depreciation reserve deficiencies, a carrier proposes significant changes that in total produce depreciation expenses that are erratic, the Commission should require

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10. Id.

11. See e.g., NARUC, Resolution Regarding the Federal Communications Commission's Notice of Proposed Rulemaking in the Matter of Simplification of the Depreciation Prescription Process, March 4, 1993 where NARUC urges that the price cap carrier option not be adopted because it provides an incentive to adjust depreciation expense in order to produce a desired level of earnings." UTS notes that FCC action in this regard does not prejudice the right of a state regulatory body to regulate interstate depreciation practices.

an additional showing by the carrier why its depreciation proposals should be accepted. An analysis of the effects of this demonstrated volatility in depreciation on sharing obligations and on reported earnings should be performed.

If, over the five year threshold, depreciation practices indicate directional stability as opposed to volatility, this fact should be accepted as evidence that the carrier is not gaming the earnings process. While a carrier might have incentives to game the process in the short run, it lacks such incentives in the long run. A carrier that over recovers through aggressive use of depreciation schedules, and that does not re-invest, will overearn in future years as its rate base shrinks in comparison to revenues. In contrast, underdepreciation accompanied by little additional investment inflates the current rate base and makes the carrier competitively vulnerable in the future. In either of these scenarios, the carrier is not balancing the use of its resources over time to promote either optimum investment or earnings and exposes itself to inevitable adverse competitive impacts. Thus, in the long run carriers have an incentive to match depreciation expense with the real useful life of investments. The continued use of remaining life and equal life group depreciation practices provide additional protection that depreciation practices will be appropriate. Further, the use of generally accepted accounting practices provides additional protection against potential depreciation abuse.

With the addition of a monitoring mechanism to discourage short-term gaming of the earnings process, the price cap carrier option is a workable solution to regulatory lag problems inherent in current depreciation practices. UTS believes this option, with the proposed safeguards; should be adopted.

**IV. The Basic Factors Range and Depreciation  
Rate Range Options Offer Incremental  
Improvement Over the Status Quo**

The Commission proposes two potential depreciation simplification alternatives that, while not as good as the price cap carrier option, offer incremental simplification and cost savings benefits. The Basic Factors Range Option<sup>12</sup> sets ranges for basic factors, such as net salvage, projection life, and survivor curve for each account. The Depreciation Rate Range Option<sup>13</sup> sets a range of actual depreciation rates for each account. Unfortunately, under either of these alternatives, many of the cumbersome and expensive steps that apply in the current depreciation process would be continued.

If the Commission were to adopt either the Basic Factors Range Option or the Depreciation Rate Range Option, it should modify its proposals to narrow the simplification gap between these second-best solutions and the price cap carriers option.

The Commission's Depreciation Rates Branch should provide oversight of the development of "benchmark" lives, on an industry

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12. Id. at 13-25.

13. Id. at 26-32.

basis, for Central Office, Circuit, Copper, Fiber and Pole accounts. Input into this development should not focus on outmoded historical depreciation but should focus on the future and include independent outside analysis by an Accounting Firm(s), a Technology Futures firm(s), and a Telecommunications Equipment Manufacturer(s), as well as the affected LECs. With this input, the Commission should be able to establish "benchmark lives" that reflect the rapidity of expected technology changes in the future and the nature of that change. Similarly, "life ranges" for all other accounts should be developed by the industry. LECs should then be allowed to adopt lives and rates that are within one or two standard deviations of the industry benchmarks.

The "benchmark lives" for major accounts and "life ranges" for minor accounts should be reviewed and approved, after notice and on an annual basis by an informal review board consisting of representatives of the industry, the Commission and State regulators. After analysis by the informal board, a recommendation should be made to the Commission for approval.

LECs should have the flexibility to adopt lives and rates that fall within one or two standard deviations of the industry benchmarks. This modification to the Basic Factors Range and Depreciation Rate Range Options would improve these plans by providing added simplicity, flexibility, and remove many of the current burdensome data requirements. Further, by providing carriers added flexibility, this modification would move the

industry and regulation in the direction of competitive market incentives with depreciation policies. However, because the price cap carrier plan would provide even more flexibility, it remains the superior option.

**V. The Depreciation Schedule Option Is  
Clearly Inferior and Should Not  
Be Adopted**

The Commission's proposed Depreciation Schedule Option<sup>14</sup> alternative is not an adequate reform of current depreciation practices. It would utilize Commission-defined average schedules and would require significant tracking of accruals by vintage. Additionally, carriers would be bound by past depreciation practices and rates.

This option is further flawed because it does not provide sufficient flexibility to carriers to deal with changing technology and competitive reality. An averaged schedule, inherently, lacks this flexibility. Additionally, significant assets will be required to track and analyze data for this plan. This provides little simplification, little cost savings, and little benefit over existing procedures.

As shown previously, rapidly changing technology and competition require a larger step in depreciation reform than the Depreciation Schedule Option provides. This option should not be considered further.

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14. Id. at ¶33-39.

## VI. CONCLUSION

The Commission is appropriately reviewing its depreciation practices in light of major changes in the industry. Due to these changes, the Commission should reform the process in such a way as to provide maximum flexibility for Price Cap carriers. The Price Cap Carrier Option is such a reform and it should be adopted.

Respectfully submitted,

UNITED TELEPHONE - SOUTHEAST, INC.

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March 10, 1993

**CERTIFICATE OF SERVICE**

I, Melinda L. Mills, hereby certify that I have on this 10th day of February 1993, sent via hand delivery or U.S. First Class Mail, postage prepaid, a copy of the foregoing "Comments of United Telephone - Southeast, Inc." in the Matter of Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, filed this date with the Secretary, Federal Communications Commission, to the persons listed below.

  
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